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FEDERAL BUREAU OF INVESTIGATION
OFFICE OF THE SECRETARY

MM Docket No. 92-266

OF

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SUMMARY

The proliferation of new and diverse cable programming networks following enactment of the 1984 Cable Act was due in large part to the absence of legislative and regulatory restrictions upon the ability of cable operators to tier, package and price their services in response to marketplace forces. The incentives to invest in new programming provided by deregulation and the ability of cable networks to expand their audience reach sufficiently to attract advertiser support have been major factors in the successful development of the so-called niche services such as A&E. The FCC must not destroy this diversity by adopting rate formulas that prevent cable networks from investing in new programming or which could operate to diminish the advertiser support which is critical to their continued survival.

The programming and pricing structure of the non-pay cable programming industry has developed based upon the "aggregate value" of a multiplicity of special interest services packaged together to provide the mass audience appeal necessary to generate advertiser support and keep subscriber fees stable. The FCC must not threaten the continued viability of existing services and stifle the development of new services by adopting rate formulas that would create incentives to drop cable networks, carry such networks on tiers having limited viewership, or which would upset the structure of the cable programming industry by seeking to convert basic cable networks into a la carte programmers.

Cable networks compete with broadcast networks for the advertiser support that is critical to the success of both industries. Broadcast networks already enjoy a competitive advantage in the marketplace by virtue of their ability to reach virtually 100% of television households versus 60% for cable networks. The 1992 Cable Act gives broadcast networks further regulatory advantages in terms of mandatory carriage, channel positioning rights and access to the widest universe of cable viewers by virtue of mandated basic tier carriage.

The FCC should not further exacerbate this marketplace imbalance by adopting rate formulas that would prevent cable operators from passing through to their customers retransmission consent costs and other programming cost increases which are direct costs of providing cable service. Furthermore, the Commission's rate formulas should not require advertising revenues obtained by cable operators from local advertising spots available on cable networks to subsidize lower rates and should not require the rates for cable programming services to subsidize a lower rate for the basic tier of broadcast programming.

Finally, the FCC must establish a presumption of reasonableness for the rates for non-basic cable programming service tiers in order to discourage frivolous rate complaints that could stifle investment in new programming.

BEFORE THE
Federal Communications Commission

WASHINGTON, D.C. 20554

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JAN 27 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Implementation of the
Cable Television Consumer
Protection and Competition
Act of 1992

Rate Regulation

MM Docket No. 92-266

COMMENTS

Arts & Entertainment Network ("A&E") hereby submits these comments for consideration by the Commission in its rulemaking proceeding to implement the rate regulation provisions of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act").¹ A&E, launched on February 1, 1984, is distributed principally to subscribing cable television systems in the United States. A&E's programming is acquired from, produced by, or co-produced with a variety of American and international sources and consists of entertainment programming in four areas -- comedy, drama, documentaries and performing arts.

¹Pub. L. 102-385, 106 Stat. 1460 (1992). Notice of Proposed Rulemaking in MM Docket No. 92-266, ___ FCC Rcd ___ (adopted December 10, 1992) ("NPRM").

Following the enactment of the Cable Communications Policy Act of 1984 ("1984 Cable Act") which provided for cable rate deregulation,² A&E increased its subscribership by approximately 400% as measured by A.C. Nielsen Company. The growth of A&E's subscriber base and the diversity and economic viability of new cable networks such as A&E, Black Entertainment Television, Nickelodeon, Lifetime and CNBC, among others, are due in large part to the absence of legislative and regulatory restrictions upon the ability of cable operators to tier and package their services in response to marketplace forces and upon the rates that cable operators could charge for their services. During those years, and for the same reasons, A&E's investment in programming increased by over 450%, to more than \$50,000,000 annually.

According to recent reports, A&E logged the fastest subscriber growth among the twelve largest basic cable services in the first quarter of 1992 from 1991. Its prime time ratings grew 33% while household delivery rose by 39% in that period.³ Much of this success is attributable to the fact that A&E has increased its investment in programming to the point where the ratio of original to acquired programming has increased to about 60%/40%.⁴ A&E's ability to continue, let alone increase, its

²47 U.S.C. §521 et seq. (1986).

³"A&E Network Tries To Hone Its Image," Multichannel News (November 30, 1992) at pp. 58-59.

⁴Ibid.

current level of investment in programming hinges directly on its continued carriage by cable operators on service tiers which are widely viewed and at rates which allow A&E to remain competitive in the program acquisition and production market.

The 1992 Cable Act's rate regulation provisions should not be implemented in a way which exacerbates the regulatory and market advantages already given to broadcasters under the statute. This would be most likely if the FCC's rate standards for basic and non-basic service caused cable operators to:

(i) remove cable networks from the basic tier; (ii) obtain local approval even for limited rate increases designed only to recover increases in programming costs and retransmission consent fees; or (iii) offer on an a la carte basis cable networks previously offered on an unregulated tier.⁵

I. Introduction

Prior to the 1984 Cable Act, only basic cable service was subject to rate regulation.⁶ Optional tiers of service, offered over and above the basic level, were immune from rate regulation.⁷ As might be expected, this regulatory regime led to

⁵As discussed more fully below, while the concept of a la carte offerings might have some superficial appeal, such a practice would cause severe disruption to existing contractual relationships and is entirely inconsistent with the programming and pricing structure of the non-pay cable programming industry.

⁶Community Cable TV, Inc., 95 FCC 2d 1204 (1983), recon. denied, 98 FCC 2d 1180 (1984).

⁷Id.

a practice of tiering, in which basic service contained only local and some distant broadcast signals. In effect, this resulted in basic service that was substantially similar to the requirements for the basic tier set forth under the 1992 Cable Act. Cable networks were typically marketed as part of a separately available tier of service, over and above the regulated basic level, so that such cable networks could be made available at an appropriate marketplace price, rather than at rates which were artificially constrained by inconsistent regulation at the local level.⁸

With the implementation of basic rate deregulation, most cable operators collapsed their tiers into a single basic level.⁹ In doing so, cable operators were able to deliver a broader cross section of potential viewers, which both facilitated the growth of advertiser supported cable networks and has also been the major factor in successful development of the so-called "niche" services such as A&E.¹⁰ Advertiser-supported cable networks have an "aggregate value" to subscribers based upon being part of a

⁸See H.R. Rep. No. 98-934, 98th Cong., 2d Sess. 24 (1984); Notice of Proposed Rulemaking in MM Docket No. 90-4, 5 FCC Rcd 259 at ¶36 (1990).

⁹Notice of Proposed Rulemaking in MM Docket No. 90-4, supra, at ¶16.

¹⁰The number of national cable video program networks increased from 49 at the end of 1984 to 76 at the end of 1991, an increase of more than 55%. Likewise, cable system programming expenditures nearly doubled during this same period from \$1.74 to \$3.46 billion. National Cable Television Association: Cable Television Developments (May 1992) at p. 7-A.

single service tier. Cable programming networks in this deregulated environment have based their services and pricing models on the assumption that a broad basic tier would encourage development of a multiplicity of diverse programming services, while providing the mass audience appeal necessary to generate advertiser support and keep subscriber fees stable. This has, in fact, been borne out by the experience of A&E and other programming services. By offering such services in a single basic package provided to all subscribers, cable operators have in fact been able to maximize consumer choice, spread costs over a wider base, and provide a multiplicity of channels for just pennies a day.

Placement on the basic tier has also provided opportunities for improving service. Cable programming networks such as A&E have become more reliant upon advertising revenues rather than affiliate fees to support their increased investment in new and original programming. The advertising revenue opportunities which placement on the basic tier offers has also allowed A&E to maintain a reasonable fee structure. Over 60% of A&E's revenues now come from ad sales. If rate regulation is imposed in such a way as to force cable operators to move cable services to higher tiers with lower penetration, or which would provide incentives for cable operators to attempt to offer A&E on an a la carte basis, advertising revenues will be severely impacted, and such cable services would have to be offered at monthly rates

analogous to premium channels if, in fact, they could be offered on an a la carte basis at all.¹¹

Broadcast networks already enjoy significant competitive advantages over cable programming networks such as A&E. First, they are given cable carriage, channel position and the preferential position on the basic tier and required to be purchased by all subscribers. Second, the broadcast networks' ability to reach the universe of all television households, including the 40% of households who do not subscribe to cable, translates directly into significant revenue. For example, the Television Bureau of Advertising estimates that total television advertising revenue in 1991 reached \$23.9 billion.¹² In contrast, total cable advertising revenue for 1991 barely exceeded \$3 billion.¹³ If cable program networks are displaced to service tiers having a smaller viewership, their ability to maintain even the current level of advertising support will be severely undermined. The Commission's rate regulation formulas should not further exacerbate the marketplace imbalance afforded to broadcasters by the many artificially imposed advantages.

¹¹A&E's production and program acquisition agreements do not permit exhibition on an a la carte basis.

¹²National Cable Television Association: Retransmission Consent: Why Bail Out The Broadcasters? (March 1992) at p. 11.

¹³Cable Television Developments at p. 9-A.

II. Tiering

The Commission has solicited comments on the extent to which Congress intended a low-priced basic tier and whether its regulations should restrict a cable operator's discretion to provide programming on the basic tier beyond the minimum statutory components.¹⁴ The Commission also questions what impact a low-priced basic service would have on programming investment and tentatively concludes that its regulatory approach should not create unintended limits on a cable operator's discretion to determine the composition of its service tiers, including basic, and thus on the continued growth of cable programming services.¹⁵

The FCC's rate formulas, and especially its basic tier rate formula, must give cable operators a reasonable incentive to carry cable programming services on the basic tier having maximum viewership. For example, the loss of viewers resulting from the placement of A&E on less widely viewed tiers will have a significant negative impact on A&E's advertising revenues, on the content and quality of the programming provided, and hence on A&E's continued viability. Although the continued development of new and existing programming is among the stated policies of the 1992 Cable Act,¹⁶ the diversity of programming desired by

¹⁴Notice at ¶32.

¹⁵Id.

¹⁶1992 Cable Act at Section 2(b)(1)-(3).

Congress will simply not be maintained where there is no financial incentive for investment. If rational rate regulation is not implemented, the quality and diversity of programming will suffer.

Nothing in the statute requires cable operators to offer a basic tier that contains few or no cable programming services. The statute only requires the FCC to issue guidelines and ensure that rates for basic service are reasonable.¹⁷ The issue is not whether a particular rate is high or low in the abstract, but rather whether the rate charged is excessive in relation to the marketplace value of, and the costs of providing, the level of service offered for a particular rate.

Although the new law only requires non-satellite delivered television broadcast stations and public, educational and governmental access channels to be offered as part of the basic service, Congress expressly provided cable operators with discretion to "add additional video programming signals or services to the basic service tier."¹⁸ Such discretionary additional services are to be "provided to subscribers at rates determined under the regulations prescribed by the Commission under this subsection."¹⁹ Clearly the Congress intended that the

¹⁷47 U.S.C. §543(b)(1).

¹⁸47 U.S.C. §543(b)(7)(B).

¹⁹Id.

cable operator be encouraged to retain cable networks on basic and to be compensated for doing so in the basic rate formula.

Given that the statute expressly allows cable operators to add non-broadcast cable services to the basic tier, the FCC should concern itself with implementing a rate regulation model that will ensure that subscribers pay marketplace or quasi-marketplace rates, and avoid a regulatory system that discourages or effectively precludes cable operators from offering additional services as part of the basic tier. One way to accomplish these ends is to design a basic rate formula and non-basic tier benchmark that is flexible enough to allow different rates to be charged by different operators depending on the number of services on that particular tier.

For these reasons, the basic rate formula proposed by the Commission which would set a basic rate that allows recovery of the "direct costs of signals plus nominal contribution to the joint and common costs" should not be adopted. Nor should the FCC leave to local governments the decision whether to permit additional compensation for those discretionary services placed on basic over and above the statutorily required broadcast and access services. Under these alternatives, cable operators would be compelled to strip down the basic tier completely and create service tiers above basic in order to be entitled to recover fully the joint and common costs of providing cable service and to otherwise avoid the prospect of a lack of fair compensation for offering more than the mandated complement on basic.

The FCC's rate guidelines also should allow cable operators whose rates exceed the level of reasonableness established by the FCC to improve service by including additional cable programming services on the basic or non-basic tier as an alternative to reducing or restructuring its rates. The Commission has long recognized cable operators must be given maximum flexibility to experiment with different approaches to marketing their services in a manner that will most efficiently distribute video programming.²⁰ Cable operators should not be prevented by regulatory fiat from having the option to improve their service in response to marketplace demands (and thereby fulfill the goal of increasing diversity) as an alternative to reducing their rate.

III. Program Cost Pass-Throughs

The FCC's basic and non-basic rate formulas should entitle cable operators to automatically pass through retransmission consent costs and other programming cost increases on the basic tier that are negotiated at arm's length between a cable operator and cable programmer or broadcaster, without the need to seek local approval for the increase or to fear the possibility of a rate rollback. For the first time in history, broadcasters may exact retransmission consent payments pursuant to newly added

²⁰Community Cable TV, Inc., supra.

subsection (b) of Section 325 of the Communications Act.²¹ Such retransmission consent fees are clearly incremental costs of providing basic service, since such broadcast signals must be carried on the basic tier. Accordingly, cable operators should be allowed to pass through these new costs to subscribers without the need for local approval. If cable operators are uncertain about their ability to recover retransmission fees, they will be forced to reduce the cost of providing service in other ways. A likely way to offset the retransmission costs of providing the basic tier would be to delete cable programming services from that tier and possibly from the system. Thus, cable programming networks, such as A&E, would effectively be forced to pay the price of any basic cost increases imposed by competing broadcast network demands.

Even the costs of providing cable programming for television exhibition have historically gone up far faster than the rate of inflation based on A&E's experience and as widely reported in industry trade press. One of the reasons for this, in A&E's view, is that the proliferation of video outlets has created a demand for programming which has outpaced the available supply, thus driving up programming prices. As additional, competing multichannel video distribution systems are developed, this competition for programming that has caused the current price escalation will further increase demand for programming, thereby

²¹New Section 325(b) was added to the Communications Act of 1934 by Section 6 of the 1992 Cable Act.

making it unlikely that programming cost increases will be kept to the rate of inflation well into the foreseeable future.

With respect to basic rates, the Commission itself has recognized that programming costs are direct costs of providing basic service and that allowing cable operators to pass these costs through to subscribers might reduce the cable operator's incentive to remove all cable network programming from the basic tier.²² This view is supported by the legislative history of the 1992 Cable Act.²³ Congress did not intend to unduly discriminate against cable programming services by requiring cable operators to offer a stripped-down basic tier of broadcast services.

IV. Advertising Revenues

The FCC has requested comment on the proper weight to be assigned to the various factors which it is required to consider in establishing a basic rate formula and non-basic rate benchmark.²⁴ One of the factors which the statute directs the FCC to take into consideration in establishing its rate formula for basic service is "the revenues (if any) received by a cable operator from advertising from programming that is carried as part of the basic service tier"²⁵ A similar provision exists with respect to the establishment of a benchmark to

²²NPRM at ¶ 54.

²³House Report at page 82.

²⁴NPRM at ¶¶ 31, 91.

²⁵47 U.S.C. §543(b)(2)(C)(iv).

determine the reasonableness of non-basic rates.²⁶ A&E urges the Commission to give little or no weight to the advertising revenues in establishing either its basic or non-basic rate formulas.

The FCC's rate formulas should not require advertising revenue obtained by cable operators from local ad spots on cable networks to subsidize a lower basic or tier rate that does not allow cable operators to fully recover their direct programming costs plus a reasonable profit on those costs. If cable operators are required to offset advertising revenues against their costs of providing cable programming services on widely viewed tiers, including basic, the result would be to create an incentive to discontinue carriage, retier or offer a la carte those cable networks that make local advertising spots available so that the cable operator could fully recover those costs. Should A&E and other cable programming services which depend in large part on revenues received from their own advertising be moved to less widely viewed tiers, these advertising revenues will severely diminish, leading to decreased programming investment, a reduction in the diversity in programming offered to subscribers, and pressure to increase system affiliate fees

²⁶47 U.S.C. §543(c)(2)(F).

and ultimately the rates for cable services paid by the subscriber.²⁷

V. Different Approach Required for Non-Basic Rate Regulation

The FCC has requested comment on whether it should apply the same standard of reasonableness with respect to the regulation of non-basic service tier rates that it ultimately adopts with respect to the regulation of the basic tier.²⁸ Although, as noted above, many of the concerns that A&E has raised with respect to the FCC's basic rate formula are equally applicable to the regulation of non-basic cable service tiers, substantial differences are warranted in the regulatory treatment of basic and non-basic services.

Initially, it is clear from the language of the Cable Act and its legislative history that Congress did not intend for the same degree of regulatory oversight for cable service tiers as for the basic tier. While Congress provided for concurrent jurisdiction over basic cable service rates to be exercised by local, state and federal authorities, regulatory jurisdiction over non-basic service tiers is limited to the FCC. By requiring local authorities to implement local rate regulation pursuant to

²⁷The offering of cable programming on an a la carte basis presents grave difficulties for a number of services, such as A&E, which have designed their services and pricing models based upon carriage as part of a constellation of special interest programming and which have in place literally hundreds of programming contracts with their own programming suppliers that do not allow those programs to be offered in such a fashion.

²⁸NPRM at ¶ 91, n. 127.

guidelines established by the FCC, it is clear that Congress contemplated that rate regulation of basic service tiers would be the norm, and not the exception, where cable systems are not subject to effective competition. In contrast, with respect to cable services, the statute limits the FCC's regulatory authority to establishing "criteria. . . for identifying, in individual cases, rates for cable programming services that are unreasonable."²⁹ Clearly, with respect to non-basic services, Congress contemplated that rate regulation would be the exception rather than the rule.³⁰

Given the likelihood that non-basic service tiers will contain some of new video programming services which are being developed to provide the diversity of programming which the legislation seeks to foster, the FCC must be careful to avoid a formula for the regulation of non-basic rates that would provide disincentives to the development of these new services. In balancing the need for greater diversity of service against the concern about higher rates needed to support the development of new services, Congress felt that rate regulation of non-cable service rates was warranted only as a fail-safe mechanism to safeguard the interests of consumers in the very rare individual cases where a particular rate could be demonstrated to be abusive or unreasonable. Accordingly, the FCC should adopt a benchmark

²⁹47 U.S.C. §543(c)(1)(A) (emphasis supplied).

³⁰House Report at p. 86.

for cable service tier rates that allows for a greater variation from the average rate for cable services than might be allowed for basic services.

A&E has already felt the adverse impact of rate regulation uncertainty during its contract negotiations with new affiliates and renewals with existing operators. A&E is not being added to some systems pending the outcome of this docket. Other operators are seeking the right to move A&E to higher tiers to avoid or reduce the harm of improper rate restraints and, in some instances, contract renewals remain unsigned. If the rates for non-basic cable service tiers are not given a high presumption of reasonableness, cable operators will have an increased incentive to offer cable programming services on a per channel basis since per channel services are excluded from local state and federal rate regulation.³¹ Such a result would be harmful both to cable programming services and to the consumer who will ultimately pay more for less service.

Offering cable services on an a la carte basis will directly increase costs to subscribers. Most cable programming services, including A&E, do not acquire the more costly pay cable rights to the programming which they purchase. Since completely different rate structures for production and exhibition may apply under collective bargaining agreements covering actors, writers and directors, depending on whether the programming is offered on

³¹47 U.S.C. §543(1)(2)(B).


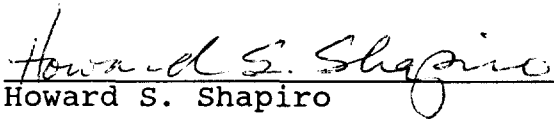
a pay or non-pay basis, any non-basic formula which would give cable operators incentives to offer cable programming services on an a la carte basis would directly drive up programming costs by requiring cable programmers to pay a higher price for production and exhibition. Either subscriber fees would have to rise to keep pace with such increased costs or the amount of original programming offered must be reduced. Furthermore, the pressure to raise subscriber fees to offset lost advertising revenue would be increased as well.

As a final matter, given the fact that the statute allows a single subscriber or franchising authority to file a complaint challenging the existing non-basic rate or any future rate increase for non-basic services, the Commission must quickly serve notice to these parties that a cable operator's non-basic rates will be given a high presumption of reasonableness and that such rates will be found unreasonable in only the small minority of situations where such rates can be considered abusive. If the Commission becomes bogged down in individual rate hearings affecting virtually every cable system in the country, such uncertainty and delay will have a chilling effect on the development of new programming services and the continued improvement of existing services.

WHEREFORE, based upon the foregoing, A&E respectfully requests the Commission to adopt basic and non-basic rate formulas that will allow tiering decisions to be dictated by the marketplace rather than regulatory considerations to the maximum extent possible and that will establish a cost pass through mechanism for programming costs and retransmission consent fees.

Respectfully submitted,

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